



## Russia: macro implications of increased geopolitical risk

The crisis in Ukraine entered the spotlight at the end of last year and grew in scale throughout January and February. The key trigger for political unrest came at the end of November 2013, after the decision of Ukraine's authorities, headed by President Yanukovich and PM Azarov, to postpone the finalisation of an FTA with the European Union. Regional tensions further escalated after Russia's President Vladimir Putin was granted permission by the Federation Council to send troops to Ukraine, which led to an abrupt increase in tensions between Russia and Ukraine as well as Russia and the West.

### From politics to the economy

In terms of the economic impact of increased political risks, the main implication at the macro level for Russia is likely to be a significant rise in capital outflows, which adversely affects the currency as well as the growth trajectory, most notably on the fixed investment side. With a higher probability of currency weakness being accentuated in the near term, inflationary pressures are likely to intensify later this year. The overall impact on the ruble could be moderated in part by the relatively favourable global economic backdrop, as well as the tightening monetary policy of the CBR.

### 2014 vs. 2008: what is different?

While in 2008-2009 the global economy was sliding into negative territory, which led to a drastic decline in oil prices, in 2014 the pace of economic growth may accelerate to well beyond 3% yoy, which should sustain oil prices at levels not too far off USD100/bbl (our commodities team projects USD97.5/bbl Brent). On the downside, however, the severity of economic isolation and the resurgence of political uncertainty may exact costs, with considerations regarding macroeconomic fundamentals likely being overshadowed by negative sentiment.

### Impact on ruble/growth

We assess the implications of political risks from Ukraine for Russia's economy through the prism of capital outflows. Our analysis implies that capital outflows of USD60bn would prompt a surge in the RUB/USD rate to a year-average of RUB/USD36.2, while much higher outflows of USD100bn could lead to an average of RUB/USD39.1. As regards the growth sensitivity, capital outflows of USD60bn would prevent Russia's economy from staging a significant acceleration this year, with annual growth of 1.4% yoy vs. 1.3% yoy in 2013, 3.4% yoy in 2012 and 4.3% yoy in 2011.

### Second-round effects are skewed to the downside

In the report we assess only the sensitivities associated with the direct effects of capital outflows on growth and the exchange rate, and do not take into account the effects of sanctions, changes in interest rates and other factors that may also have a significant impact on the macro outcomes this year. With respect to the sanctions, we believe their overall direct effect is likely to be limited for the economy but may add to capital outflows even if sanctions are not fully applied but simply discussed publicly. In terms of the effects of the interest rate changes, their temporary nature is likely to result in a limited effect on lending and growth; however, if the current political uncertainty proves to be persistent, the elevated rates could linger and have a greater adverse effect on growth this year. Another factor that may affect Russia's outlook in the 2014-2015 period is the risk to the sovereign credit rating, something that was stated by Moody's earlier this month. All this implies that the estimates of the costs to the rouble and growth resulting from capital outflows should be seen as the lower bound of the total effect, which takes into account other factors, including sanctions.